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ICPS newsletter

Over 2000–2002, Ukraine will experience 10-percent economic growth

A new issue of ICPS's Quarterly Predictions journal will be published this week. In this issue, we offer our first forecast for economic development in 2002. We forecast that demand and productivity in Ukraine will grow over 2000–2002. In 2000, increased domestic demand and favourable conditions in foreign markets will stimulate economic growth, which will reach 2%. In 2001, Ukrainian GDP growth will accelerate to 3.5%; demand for investments will increase and productivity in the agricultural sector will rise, thanks to the reforms. Finally, economic growth in Ukraine will reach 4% in 2002, thanks to larger investment volumes resulting from a more consistent economic policy

In H1'00, GDP growth reached 5%. This economic revival resulted from favourable conditions in world markets and increased domestic demand. Growth in the industrial sector compensated for the slump in the agricultural sector.

In 2000, a majority of Eastern European countries have seen economic revival. GDP growth in this region has substantially outpaced the respective indicators of developed economies. For example, GDP in Q1'00 increased by 6.6% in Hungary, by 6.0% in Poland, 3.6% in Czech Republic, 9.1% in Kazakhstan, and 8.4% in Russia.

Will Ukraine take full advantage of the economic revival in the region? Firstly, higher incomes in neighbouring countries will enhance Ukrainian exports. Secondly, foreign investors should become more interested in the region overall. Thus, Ukraine will have to compete for investment with other transition economies, particularly Russia. Whether or not Ukraine succeeds in this competition will depend on the quality of economic policy oriented on increasing productivity.

Economic growth in Ukraine, as well as in other countries in the region, is driven by increased demand. The Consumer Confidence Survey, jointly conducted by ICPS and the GfK–USM Company, indicates that demand in Ukraine is potentially high; Ukrainian consumers estimate their future incomes more optimistically than their current financial position. Therefore, we anticipate that domestic demand will continue increasing. This, together with favourable conditions in world markets, will stimulate economic growth.

Unlike Ukraine, other Eastern European countries succeeded with economic reforms and created conditions for stable economic growth. Lagging behind in creating the competitive environment needed to stimulate private entrepreneurship, Ukraine is likely to fail in attracting investments. However, Ukraine has comparative advantages, such as lower labour costs and a flexible labour market.[1] They may become deciding factors for potential investors, once domestic business conditions have been improved.

Since the increase in demand is outpacing productivity growth in Ukraine, economic growth will reach only 2% in 2000. In 2001, GDP growth will accelerate to 3.5%, due to increased investment demand and higher productivity in the agricultural sector. Thanks to rising productivity determined by the government's investment-friendly economic policy, GDP will grow by 4% in 2002, despite increased imports and worsened trade balance.

We build our forecast on the following assumptions:

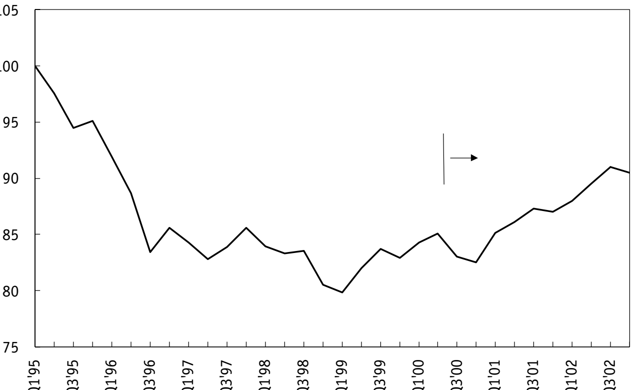
1. Political stability. Supported by the President and the Verkhovna Rada, the Ukrainian government will be able to implement reforms and improve its decision making, which will create conditions for stable economic growth.

2. Integral legislative framework. We anticipate that the civil, tax, and land codes will be approved over 2000—2002. These codes will entrench the right to private

[1] According to the rating of *The Economist's* Intelligence Unit, Ukraine takes fifth place by labour market parameters.

Real GDP

Index [Q1'95 = 100], seasonally adjusted



Source: State Statistics Committee; calculations and forecast by Quarterly Predictions.

entrepreneurship and encourage business activity. Moreover, high-quality and integrated legislation will minimise the need for adopting additional normative acts, thus ensuring legal environment stability and restricting government interference.

3. Fair competition, thanks to the liquidation of tax privileges (as envisioned in the draft Tax Code), and consistent liberalisation of foreign trade will encourage businesses to invest.

4. Effective privatisation. With consistent privatisation policy, effective owners, who can bring in capital and the latest technologies, will start managing the biggest Ukrainian enterprises.

5. Openness of the economy. Ukraine's adherence to international business regulations after joining the World Trade Organisation, and intensified integration processes in Europe, will encourage foreign investment inflows. We also envision that the IMF will renew the EFF program for Ukraine in Q3'00.

The risks to stable growth in Ukraine are the following:

• Tactical decisions may outweigh strategic tasks if decision-making processes in the government remain weak.

• Local governments will lack the institutional capacity to carry out reforms initiated by the central government.

• Postponing implementation of the Land Code (which particularly concerns land as collateral) will deter creditors from lending to agricultural enterprises, which will exhaust the financial resources of the sector.

• Instability in the energy sector. Although the threat of an electricity crisis remains real, primarily because of poor contract enforcement, we believe that the crisis will not explode, due to the amendment of the Law "On electricity". Meantime, the risk of government interference in the energy sector has been increasing, thus deterring strategic investors and restraining its long-term development.

• Conditions in foreign markets may worsen, which would result in the reduction of output by export-oriented enterprises.

• Foreign investor confidence in Ukraine will not be restored. International investors consider the reforms in Russia to be more serious than in Ukraine.[2] Therefore, Ukraine will remain under-invested in the nearest future. ■

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[2] For example, *Lehman Brothers* give a positive assessment of the economic strategy of the Russian government—in particular, the measures for improving conditions for private sector development and foreign investment inflow.

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Major indicators

	1999	2000 (forecast)	2001 (forecast)	2002 (forecast)
Economic activity				
GDP, millions UAH	127126	162900	187800	216900
Real GDP, apc*	-0.4	2.0	3.5	4.0
Real industrial production, apc	4.3	5.0	4.5	5.5
Real agricultural output, apc	-5.7	-6.2	7.1	7.9
Gross investment, % of GDP	19.8	18.9	19.0	19.4
Direct investments, millions USD (1)	489	700	1100	1200
Real household disposable income, apc	1.2	3.0	4.0	6.0
Real retail turnover, apc	-4.8	7.0	5.0	6.0
Prices				
Consumer price index, apc	19	26	15	11
Producer price index, apc	16	18	15	12
Labour market				
Population, millions	49.7	49.4	49.1	48.9
Real wage, average apc	-5.7	1.0	2.5	3.0
Official unemployment rate, %	4.3	5.5	6.0	8.0
Foreign economic activities				
Exports of goods&services, apc	-7.9	5.2	2.3	2.6
Imports of goods&services, apc	-19.1	6.1	3.9	4.7
Current account balance, % of GDP	2.7	2.2	1.3	-0.5
Budget				
Revenues (consolidated), % of GDP	25.9	27.0	27.0	25.5
Current balance, % of GDP	-1.5	0.4	0.7	-0.5
Primary balance, % of GDP (2)	0.9	3.5	3.7	2.5
Monetary indicators				
Monetary base, apc	39	26	19	17
M3, apc	41	32	21	18
NBU international reserves, millions USD	1094	1240	1500	1830
Official exchange rate, average annual, UAH/USD	4.13	5.76	6.80	7.50
Interest rate on loans, average annual, yearly % (3)	53	43	36	30
International				
World GDP, apc	3.3	4.4	4.1	3.8
GDP of Ukraine's major trading partners (2/3 of exports), apc	3.0	4.0	3.7	3.5

** apc = annual percent change*

Notes:
(1) according to the NBU
(2) current balance plus state debt servicing
(3) commercial bank loans, hryvnias

Source: State Statistics Committee, NBU, Finance Ministry; calculations and forecast by Quarterly Predictions.